Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

ORIGINAL

In the Matter of	)	
	)	
GTE CORPORATION,	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-
	)	
BELL ATLANTIC CORPORATION,	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer of Control	)	

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

REPLY COMMENTS OF CABLE & WIRELESS, INC.

Cable & Wireless, Inc. ("C&W"), by its attorneys, hereby submits these reply comments on the Supplemental Filing of Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE"), collectively, "Applicants."[1] C&W is a leading provider of data, Internet, and long distance services with ongoing plans to integrate and upgrade its networks in order to provide a full range of integrated, basic, and advanced telecommunications services packages to consumers. As one of the largest participants in the Internet backbone market, C&W has a vested interest in a competitive Internet backbone marketplace, and accordingly, in this proceeding.

For the reasons discussed below, C&W has serious concerns about the divestiture of GTE-Internetworking ("GTE-I") from GTE as proposed. In fact, C&W believes that the divestiture as proposed would not result in a separate, stand-alone entity, as required by the Act. Rather, both the structure of the proposed arrangement along with the substantial remaining

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incentives for ongoing entanglement between the merged Bell Atlantic/GTE entity ("merged entity" or "NewCo") and the divested company (known as "DataCo") would cause NewCo to exercise *de facto* control over DataCo in violation of section 271 of the Act.

I. Under the Divestiture Proposal, NewCo Would Retain Control Over the Divested Entity in Violation of Section 271 of the Act.

A. The Proposed Structure of the Arrangement Would Cause NewCo to Exercise *De Facto* Control over DataCo.

C&W strongly supports the initial comments filed by the parties, such as the Competitive Telecommunications Association ("CompTel"), which stated that the divestiture as proposed would enable NewCo to have *de facto* control over DataCo.[2] In reality, this proposed arrangement is merely an exercise in form over substance. Under the proposed arrangement Applicants would have *de facto* control over DataCo by virtue of (1) Applicants' 10% interest in DataCo; (2) Applicants' right to acquire at least an 80% interest as soon as Bell Atlantic obtains appropriate Section 271 authority;[3] (3) and investor protections guaranteeing that no person or entity would be able to gain control of DataCo through either the purchase of equity or the purchase of debt.[4] As a result, the merged entity would be providing in-region interLATA services on the date of divestiture in violation of Section 271.[5]

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1 Supplemental Filing of Bell Atlantic and GTE, CC Docket No. 98-184 (filed Jan. 27, 2000) ("Supplemental Filing"); *see Public Notice*, DA 00-165 (rel. Jan. 31, 2000).

2 *See* Comments of the Competitive Telecommunications Association at 2 ("CompTel Comments").

3 *See Supplemental Filing* at 35.

4 In particular, the merged entity's approval is necessary prior to DataCo incurring debt beyond a stated level. *See id.* at Schedule A (Investor Safeguards).

5 *See* 47 U.S.C. § 271. The Commission has only granted Bell Atlantic authority to enter the interLATA long distance market in the State of New York. *See Application of Bell Atlantic New York for Authorization under Section 271 of the Communications Act to provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, FCC 99-404 (rel. Dec. 22, 1999). Section 271 of the Act prohibits a Bell Operating Company ("BOC") or any of its affiliates from providing in-region interLATA services until such BOC has obtained appropriate authority. The term "affiliate" is defined as "a

The structure of the transaction, specifically the investor safeguards, ensures not only that NewCo would control DataCo, but also that the Class A shareholders never would control DataCo. As both CompTel and AT&T stated in their initial comments, Applicants have guaranteed that NewCo's 10% equity interest would make it the largest single shareholder in DataCo.[6] Applicants also have guaranteed that no other entity could obtain more voting power than the merged entity. In particular, the Class A shares of stock would contain a provision preventing "any single holder or group (as defined under SEC rules) from voting more than 10% of the Class A stock."[7] The investor protections further guarantee that the Class A shareholders, even though they initially would hold 90% of the stock of DataCo, would never have control of DataCo. For example, a vote by the Class B shareholders (or by the merged entity in some situations) would be required prior to allowing a change in the nature of the business or prior to issuing debt beyond a stated level. Moreover, the Class A shareholders could not prevent the merged entity from exercising the conversion rights.[8] Thus, NewCo would control DataCo from the date of divestiture until, and subsequent to, the conversion of DataCo's stock.

In addition, the vague and undefined joint marketing arrangements proposed between NewCo and DataCo, in addition to the other factors identified above, would give NewCo control over DataCo in violation of Section 271 of the Act. Applicants specifically state that they either would market or jointly market DataCo's services even prior to the merged entity exercising its

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person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership with, another person." 47 U.S.C. § 153(1).

6 *See* AT&T Comments at 26; CompTel Comments at 4-5.

7 *Supplemental Filing* at Appendix A (Investor Safeguards).

8 As explained by Applicants, the merged entity's 10% equity interest automatically converts to an 80% interest at the merged entity's option thus diluting the Class A shareholder interests to 10%.

option in DataCo. Applicants, however, have not provided any specifics about such marketing arrangements.[9]

Additionally, the Applicants have proposed a structure that would ensure that DataCo would be dependent upon the merged entity post-divestiture such that the merged entity would control DataCo. Applicants concede that GTE-I currently shares many resources with GTE, and thus, that DataCo would remain dependent upon NewCo in numerous critical ways.[10] In Appendix B, Applicants note that DataCo would receive the following services from NewCo: employee benefits support; billing and collections; procurement; treasury services; and information technology support.[11] Applicants further state that DataCo would continue to rely upon its agency and reseller arrangements with Bell Atlantic for an undetermined period of time, and that such arrangements might extend to "volume purchase commitments" for customers who purchase services from both DataCo and NewCo, thus allowing NewCo to create an ongoing operational dependency between NewCo and DataCo. Moreover, DataCo does not have any obligation to use any outside vendors to purchase its support services. Accordingly, there is no guarantee that the arrangements DataCo enters into with the merged entity would be obtained

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9 Even if the Commission finds that no control exists, the joint marketing arrangements raise serious compliance concerns with Section 271 of the Act. *See, e.g., AT&T Corp. v. Ameritech Corp.*, 13 FCC Rcd 21438 (1998), *aff'd sum nom., U S West Communications, Inc. v. FCC*, 177 F.3d 1057 (D.C. Cir. 1999) (finding that certain teaming agreements between U S West and Qwest and between Ameritech and Qwest violated section 271 of the Act).

10 In the normal situation where a company operates an integrated Internet backbone business, there are numerous areas of inter-dependence: (i) the same sales people (and associated support staff) sell both Internet backbone services and other telecommunications services; (ii) the Internet backbone operation relies upon the parent company for billing and collection services; (iii) the same engineering and technical staff support all operations; (iv) the Internet backbone business obtains some or all of its underlying capacity from the parent company; (v) customer contracts include multiple services in addition to Internet backbone services; (vi) the same account representative interacts with the customer for all types of services; (vii) the databases necessary for critical customer support functions may be used jointly for GTE-I and GTE services; and (viii) the Internet backbone business uses routers and other equipment that is located at or inside the POPs of the parent company.

through arms-length transactions or through the competitive bidding process. Together with the proposed investor safeguards, these ongoing exclusive relationship will ensure that DataCo will never operate as a separate, stand-alone entity.

The Commission cannot permit the divestiture as proposed to proceed. Instead, the Commission must require the full and complete divestiture of GTE-I and ensure that DataCo is not an affiliate of the merged entity. As proposed by CompTel, such a full and complete divestiture would require eliminating the Applicants' conversion rights, prohibiting Applicants from reacquiring a controlling interest for five years, and adopting the conditions necessary to ensure that the divested entity can operate as a stand-alone competitor in the Internet backbone market on the day of divestiture.

B. The Incentives for Ongoing Entanglement Will Cause NewCo to Exercise De Facto Control Over DataCo.

In addition to the structural problems described above, the lack of incentive of NewCo to fully divest DataCo into a separate stand-alone entity would compound the already inherent difficulties associated with divesting a fully integrated asset. Moreover, given the tight integration between GTE-I and GTE, it would be virtually impossible to ensure that the divestiture results in the creation of a separate stand-alone company—that functions independently of NewCo—without a detailed divestiture plan followed by stringent regulatory oversight. It is inherently difficult to divest a fully integrated asset even when the company voluntarily divests such an asset. Because the merged entity will exercise its conversion rights in DataCo as soon as the merged entity obtains sufficient interLATA authority, applicants have an incentive to divest, as a practical matter, as little of GTE-I as possible. Thus, without a detailed

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11 *See Supplemental Filing* at Schedule B.

divestiture plan and stringent Commission oversight, Applicants likely would structure DataCo to preserve, as much as possible, the integration of GTE-I into the merged entity.

In its comments, CompTel demonstrated that the tight integration between GTE-I and GTE virtually guarantees that the merged entity would exercise *de facto* control over DataCo after the divestiture. Based upon C&W's own experience regarding the divestiture of integrated Internet backbone assets, we believe that NewCo would never allow DataCo to function as a separate, stand-alone competitor in the Internet backbone marketplace. C&W's concerns are heightened by the Applicants' failure to submit any detailed plan outlining how the proposed divestiture would be accomplished. For example, Applicants have not provided any information regarding the transfer of personnel, resources, or contracts. Without a detailed plan outlining the divestiture of GTE-I from GTE, the only conclusion available to the Commission is that DataCo would not be able to operate as a separate stand-alone entity.

C&W's own experience in purchasing the iMCI business from MCI in 1998 illustrates the difficulty of divesting a fully integrated asset such as GTE-I when the divesting party's incentives to divest the asset are not fully aligned with the efforts that must be made to accomplish that task. In the *MCI WorldCom Merger Order*, to ensure that the Internet backbone market remained competitive, the Commission, in agreement with both the European Commission and the Department of Justice, approved the merger only on the condition that MCI divest its iMCI business. Despite the Commission's directive, MCI WorldCom failed to fully divest the iMCI business. Among other things, it failed to transfer all necessary personnel; to provide basic customer service information and contracts; and to provide access to necessary databases. Instead, MCI WorldCom transferred to C&W an entity that could not function as a stand-alone Internet backbone provider.[12] The failure of MCIWorldCom to fully divest iMCI into a separate stand-alone entity can be traced directly to the fact that the divestiture was not voluntary and the divestiture would result in the creation of a new competitor to UUNet, which remained as the Internet operations of the merged MCI/WorldCom entity. As a result, MCI WorldCom had a strong incentive, as well as ability, to sabotage the divestiture to the detriment of C&W and to the benefit of UUNet.

In the present situation, the proposed divestiture is similarly doomed to fall short of achieving the level of separation necessary to create a separate stand-alone competitor, because, again, it is not voluntary and DataCo would only temporarily be "owned" by the public. Because of its retention of conversion rights, NewCo has a strong, countervailing incentive and ability to create an entity that remains operationally dependent upon NewCo, rather than a independently-operating, stand-alone competitor.

In short, given the tight integration between GTE-I and GTE, the lack of incentive for GTE to fully divest GTE-I, as well as the failure of Bell Atlantic and GTE to offer a detailed plan of divestiture, the Commission must conclude that the merged entity would continue to exercise *de facto* control over DataCo at divestiture. As a result, the proposed divestiture would result in Bell Atlantic providing in-region interLATA services in violation of Section 271. Thus, prior to approving any divestiture, the Commission must require Applicants to submit a detained plan that ameliorates the problems identified above. Specifically, the Commission must require Applicants to provide a detailed plan that, at a minimum, accomplishes the following: (1) restructures the allocation of the stock; (2) removes NewCo's conversion rights; (3) eliminate the proposed joint operations; and (4) specifically details the proposed divestiture, including, for

[12] MCI WorldCom's failure to transfer a separate stand-alone entity are detailed more fully in C&W's comments to the proposed MCI WorldCom/Sprint merger, and are provided as Exhibit 1 to these comments.

example, a list of employees and facilities that would be transferred to DataCo. The Commission must permit all interested parties to comment on this proposed divestiture. Additionally, if the Commission approves a divestiture, the Commission must exercise stringent oversight over the actual divestiture process.[13]

II. The Proposed Divestiture Would Not Promote Competition In The Internet Backbone Marketplace.

In an effort to bolster an otherwise legally deficient Application, Bell Atlantic and GTE contend that the proposed divestiture would enhance competition in the Internet backbone market. That contention is both irrelevant and wrong. It is irrelevant because the proposed divestiture would enable the merged entity to control DataCo. Accordingly, the merged entity would be an affiliate of DataCo and would be providing in-region interLATA services in violation of Section 271 of the Act. The Commission does not have the authority to overlook that illegality based on the Applicants' speculation about Internet backbone competition.

Further, C&W takes strong issue with the Applicants' belief that the proposed divestiture would promote Internet backbone competition. The proposed divestiture should be recognized for what it is – a desperate attempt by the Applicants to salvage their merger, not a plan to enhance Internet backbone competition. Given GTE's current position as one of the top Internet backbone providers, it is difficult to fathom that somehow this merger is necessary to enhance that position.[14]

Lastly, C&W wishes to clarify for the record certain statements made by the Applicants regarding C&W's performance subsequent to the divestiture of the iMCI business to C&W in

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13 *See* James V. Grimaldi, *FTC to Get Touch on Merger Reviews*, WASH. POST, Feb. 17, 2000, at E1 (stating that the staff has already begun stiffening the requirements placed on corporations that suggest spinning off assets, in part, because companies divested businesses that were not viable stand-alone entities).

1998. In particular, the Applicants state that C&W's share in this market segment has "fallen precipitously" due to problems experienced with the iMCI divestiture.[15] Although, as explained in great detail in its comments filed on the proposed MCI WorldCom/Sprint merger, C&W was forced, in response to MCI WorldCom's failure to fulfill the terms of its divestiture commitments, to dedicate substantial resources and undertake significant remedial efforts to re-establish the Internet business acquired in the wake of the MCI/WorldCom merger, C&W remains a strong competitor in the Internet backbone market.[16] Hence, the problems associated with the iMCI divestiture lend no support to the Applicants' request that the Commission approve the proposed GTE-I divestiture.

III. Conclusion

In conclusion, C&W submits that the Commission should reject the proposed divestiture of GTE-I for the reasons stated by CompTel and other parties.

Respectfully submitted,

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February 22, 2000

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14 *See* Exhibit 1 at Attachment K (Pearce Affidavit) at 8-11 (stating that GTE has the second largest share of the Internet backbone marketplace (16%) behind only MCIWorldCom).

15 *Supplemental Filing* at 4-5.

16 *See* Exhibit 1.

CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of February, 2000 I served copies of the foregoing Reply Comments of Cable & Wireless, Inc. for Cable & Wireless, Inc. either by hand or by mail, first-class postage prepaid, on the following:

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EXHIBIT 1

Comments of Cable & Wireless, Inc.
CC Docket No. 99-33
(filed February 18, 2000)

STAMP AND RETURN

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In re Applications of	)	
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SPRINT CORPORATION	)	
	)	
Transferor,	)	
	)	
and	)	
	)	
MCI WORLDCOM, INC.	)	CC Docket No. 99-333
	)	
Transferee,	)	
	)	
for Consent to Transfer	)	
Control of Corporations Holding	)	
Commission Licenses and Authorizations	)	
Pursuant to Section 214 and 310(d) of the	)	
Communications Act and	)	
Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101	)	

To: The Commission

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FEDERAL COMMUNICATIONS COMMISSION
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COMMENTS OF CABLE & WIRELESS, INC.

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February 18, 2000

SUMMARY

Cable & Wireless, Inc. ("C&W") does not object to the proposed merger of Sprint Corporation ("Sprint") and MCI WorldCom, Inc. ("MCI") (together Sprint and MCI are referred to herein as the "Combined Carrier") so long as appropriate safeguards are enacted to preserve Internet backbone competition. If the Combined Carrier is allowed to take control of the Internet backbone market, competitors, along with the broader public will be directly and irreparably harmed. Only the divestiture of UUNet will promote the public interest and maintain a competitive Internet backbone market.

The Merger Application places the future of the Internet in the hands of the Commission. If the Sprint and MCI Internet backbone assets are combined, MCI will have the ability and incentive to bend the Internet to its will. The result will be harm to consumers, the economy, and technological innovation. By requiring that UUNet be divested, the Commission will promote Internet backbone competition, and avoid the need to regulate the Internet in the future. Otherwise, the Combined Carrier would severely harm U.S. consumers by substantially increasing the rates paid by consumers for Internet services. Consumers who today could afford services will be prevented from doing so post-merger by higher prices. Additionally, the introduction of premium Internet services will be limited to those who are able to pay the Combined Carrier's above-market rates.

By every possible relevant measurement standard, the merger would result in a company too large to be constrained by competition. Today, MCI enjoys a commanding position in the Internet backbone market with a market share by revenue of 37%. The Combined Carrier would control at least 45% of the total Internet backbone market, and would control nearly 70% of the Internet wholesale service market. Further, the Herfindahl-Hirschman Index ("HHI") – with a pre-merger HHI for the Internet backbone market of 1,774, and the post-merger HHI of 2,266 –

indicates that the proposed merger presumptively creates or facilitates the exercise of market power. Such market characteristics indicate that the market is likely to be "tipped" into a monopoly and once tipped, would likely remain a monopoly.

The increased Internet backbone concentration proposed by the merger will have an adverse impact on every Internet-related marketplace, not just the backbone market. For ISPs and ASPs, the likely elimination of peering arrangements and the increase in transit rates will have a significant adverse impact on their long-haul costs. In addition, because MCI operates a variety of Internet businesses their own, the Combined Carrier could dominate the ISP market by discriminating against other ISPs. If approved, the merger could deliver not one, but two Internet markets (backbone and ISP/ASP) to the Combined Carrier.

The Commission has recognized Congress' desire to develop the advanced services marketplace to the benefit of all Americans as quickly as possible. The combination of MCI's and Sprint's Internet backbone networks would stunt the growth of emerging advanced services such as xDSL and undermine the emerging market for premium Internet services such as IP telephony, real-time video conferencing, and mission-critical business applications through transmission quality or lack thereof alone.

The Commission should learn from past experience in deciding which Internet backbone assets – UUNet or Sprint – should be divested. C&W has a unique perspective because C&W purchased the iMCI business less than 18 months ago under identical conditions. Based upon its experience, C&W submits that several factors require the divestiture of UUNet rather than Sprint's Internet business.

In cases where business assets and operations are integrated into an entity's other activities, it is inherently problematic, if not futile, to suggest that forcing the divestiture of those assets will result in a viable stand-alone competitor from day one, particularly when the divesting entity will continue to compete in the same market segment. In addition, the nature of the divestiture directly affects the scope and nature of the conditions the Commission must impose and the monitoring and enforcement obligations it must undertake.

Were the Commission to order MCI to divest the Sprint backbone operations, the Commission would be required to impose a complex series of granular conditions to ensure that the entity is fully divested as a robust, stand-alone competitor and that MCI provides the necessary support services on an ongoing basis for a year or more. The Commission would have to supervise the divestiture conditions and enforcement requirements to create the divested entity, and then actively monitor and implement those requirements and conditions to ensure that the divested entity could function effectively as a strong backbone competitor. The divestiture of UUNet would entail considerably less ongoing Commission oversight and enforcement, and because UUNet continues to operate almost independently from the rest of MCI WorldCom, there is little doubt it would remain a strong competitor on the first day of divestiture.

C&W's experience in acquiring iMCI as part of the MCI WorldCom merger is highly instructive in evaluating MCI WorldCom's latest proposed merger. The Commission should take away two primary lessons from this experience. *First*, MCI and Sprint must be required to divest the Internet backbone asset that is least integrated with their other telecommunications and non-Internet business activities. *Second*, the Commission cannot rely on MCI to honor its commitments to fully and completely divest an Internet backbone business.

MCI's divestiture of its backbone facilities have presented C&W with every possible obstacle to overcome. Half of the necessary customer contracts were not produced until at least seven months after closing. Further, MCI restricted, denied, or delayed database access to large numbers of C&W personnel and left C&W's sales force to spend much of their time dealing with customers' billing issues. The result of which has been hundreds of dedicated Internet access customers withholding millions of dollars from C&W because of billing problems.

The severe adverse impact on C&W of MCI's pattern and practice of non-compliance with its commitments regarding the iMCI divestiture is readily apparent. The iMCI business transferred to C&W was a significantly weaker competitor as a stand-alone business than as an MCI operating unit. C&W's ability to retain and expand its Internet business was undermined by the lack of adequate and sufficient personnel, information, and services. While iMCI experienced growth rates of 50-100 percent prior to divestiture, this dramatic growth abruptly ceased after the sale of the business to C&W. From September 1998 through July 1999, the customer base in each of C&W 's Internet businesses fell, and revenues were either flat or declining.

Sprint's Internet business is integrated into Sprint's other telecommunications businesses in the same way that iMCI was integrated into MCI's other businesses, while UUNet historically has operated, and operates today, on a more stand-alone basis. Because UUNet continues to operate as a stand-alone company, MCI would have significantly less ability to sabotage the divestiture with the result that, assuming modest Commission oversight of the divestiture process, UUNet will be a strong and vibrant Internet backbone competitor at the time it is divested. By contrast, divesting the Sprint Internet backbone business would give MCI the same opportunity that it had with iMCI to ensure that the divested company is a weaker competitor than it was when operated on an integrated basis, a handicap that will require one to two years for the new owners to overcome, which, in an explosive growth industry like the Internet, is an eternity.

Based on the problems of the iMCI divestiture, the Commission must take an active role in supervising the divestiture of UUNet. Fortunately, because UUNet is operated largely on a stand-alone basis, the Commission can ensure a pro-competitive result by adopting and enforcing a set of baseline divestiture standards and conditions. The Commission's role should include: (1) a review of the relevant transactional and other documents; (2) a verifiable commitment to divest; (3) independent audits at three months and one year; and (4) corporate compliance program.

Simply put, this merger threatens the entrepreneurial and competitive foundations of the Internet, and, in turn challenges the Commission's ability to continue its long-standing policy of "unregulating" the Internet. However, by taking the appropriate and necessary steps to condition this merger upon the divestiture of UUNet, the Commission can and should continue to pursue this right-minded policy and ensure that consumers continue to reap the life-changing benefits of a competitive Internet.

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To: The Commission

COMMENTS OF CABLE & WIRELESS, INC.

Cable & Wireless, Inc. ("C&W"), by its attorneys, hereby comments on the proposed merger between Sprint Corporation and its affiliates (together "Sprint") and MCI WorldCom, Inc. and its affiliates (together "MCI") (Sprint and MCI collectively referred to as "Combined Carrier").[1] C&W has serious concerns with the merger as proposed. C&W does not object to the Commission's approval of the merger so long as the Commission imposes the conditions

[1] *Applications of Sprint Corp., Transferor and MCI WorldCom, Inc., Transferee, for Consent to Transfer Control for Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90 and 101*, CC Docket 99-333 (filed Nov. 17, 1999) ("*Merger Application*"); *Supplemental Internet Submission*, CC Docket 99-333 (Jan. 14, 2000); *Commission Seeks Comment on Joint Applications for Consent to Transfer Control Filed by MCI WorldCom*, CC Docket No. 99-333, FCC Public Notice (Jan. 19, 2000).

necessary to preserve and promote Internet backbone competition through the divestiture of MCI's Internet subsidiary, UUNet.

C&W is a leading provider of data, Internet, and long distance services with ongoing plans to integrate and upgrade its networks in order to provide a full range of integrated, basic and advanced telecommunications services packages to consumers. As one of the largest participants in the Internet backbone market, C&W has a vested interest in a competitive Internet backbone marketplace. If one entity is able to seize control of the Internet backbone market, C&W, along with the broader public, will be directly and irreparably harmed. Because the proposed merger would place too much of the Internet backbone in the hands of one carrier, the Commission must condition its approval of the merger on the full and complete divestiture of UUNet.

In the Merger Application, MCI and Sprint essentially ignored the Internet backbone issue, and went so far as to suggest that the Commission should simply defer to whatever the parties could negotiate with the Department of Justice.[2] They took that position despite the Commission's unambiguous holding in the context of the MCI merger that it has independent authority to review a merger's impact on the Internet backbone market.[3] The Commission should take this opportunity to reaffirm its authority to take into account the impact of the proposed merger on this key telecommunications market segment. Further, C&W urges the Commission to coordinate closely with other U.S. Government agencies, including the Department of Justice, to ensure that the merger is conditioned as necessary to promote the

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2 *MCI WorldCom 1998 Merger Application* at 6.

3 *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, Report and Order, 13 FCC Rcd 18025, para. 8 (1998) ("*MCI WorldCom Merger Order*").

public interest. Active inter-agency cooperation is crucial not only due to the Commission's expertise on the inter-relationship of Internet and telecommunications services, but because the Commission is in the best position to appreciate the ongoing implementation and enforcement issues regarding the divestiture of Internet assets. As we show in detail below, a divestiture of Internet backbone assets is necessary for the proposed merger to promote the public interest in a competitive Internet backbone market, and only the divestiture of UUNet will promote that objective.

The Merger Application has placed the Commission at the crossroads of the Internet industry. If the Commission approves the merger without requiring the divestiture of UUNet, MCI will lock up a dominant position in the Internet backbone market. It will have the ability and incentive to do what no single entity has yet succeeded in doing – bending the Internet to the will of one company. The resulting harm to consumers, the economy, and technological innovation is unlikely ever to be undone. By requiring MCI to divest UUNet, the Commission will promote competitive conditions in the Internet backbone market, thereby ensuring that market forces, not market power, will be the single most powerful driving force in the development of the Internet.

I. Introduction

Although given short shrift in the Merger Application, the issue of Internet backbone facilities concentration is critical for Americans. The Internet is a social, technological and economic phenomenon that has changed the way we communicate, do business and live. It has created new businesses and new jobs, while radically changing almost all pre-existing businesses and jobs. The Internet has already become an integral part of the lives of many tens of millions of Americans, and its influence will grow larger by leaps and bounds in the years ahead.

As the term "backbone" implies, the Internet backbone network gives life and structure to the Internet. A non-competitive Internet backbone market will result in higher charges for connecting Internet Service Providers ("ISPs") and ultimately for consumers. Higher charges will exclude many Americans from enjoying the benefits of the Internet, thereby increasing the so-called Digital Divide between those Americans who have access to the Internet and those who do not. In addition, with competition stunted at the backbone level, rapid innovation in the downstream markets, which has been the hallmark of the development of the Internet, also will be greatly diminished.

In support of these comments, C&W submits on the record the attached affidavit of Dr. Alan Pearce, former Chief Economist of the Commission.[4] As Dr. Pearce shows, UUNet is far and away the largest Internet backbone provider by almost any measure, including revenues, investment and customers.[5] It is close to dominating the Internet backbone market today, and the addition of Sprint's Internet backbone will increase concentration still further and tip the market into one that is dominated by MCI. Without conditions to protect the public interest, the merger of MCI and Sprint will give the Combined Carrier a choke hold on the infrastructure that gives life to the Internet.

The following harms will occur if the Commission permits MCI and Sprint to create a single behemoth Internet backbone carrier:

1. The Combined Carrier will have the power to eliminate peering arrangements and raise transit rates. This will increase the costs of ISPs and ultimately increase Internet subscription costs for Americans. Subscribers who cannot afford those rates will be kept off the Internet.

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4 Internet Affidavit of Dr. Alan Pearce, February 17, 2000 ("Pearce Affidavit").

5 Pearce Affidavit at 6-8, 14.

2. The Combined Carrier will unilaterally control the manner in which ISPs interconnect. It will be able to discipline other backbone providers and ISPs by refusing to interconnect with them, or degrading the quality of interconnection through congestion and failure to upgrade capacity.

3. The Combined Carrier will deter market entry by backbone providers and ISPs, leading to consolidation and lessened competition in those market segments. Once again, consumers will suffer through higher Internet subscription costs, and those who cannot afford them will be kept off the Internet.

4. The Combined Carrier will stunt the development of the market for advanced services, such as xDSL services. These services will be available to fewer Americans, and they will cost more.

5. The Combined Carrier will dominate downstream markets for premium Internet services, which require guaranteed quality of Internet backbone transmissions.

6. Through vertical integration and strategic pricing and interconnection practices, the Combined Carrier could threaten competitive conditions in the downstream ISP market.

7. A single carrier will take control of the facilities that touch the lives of nearly every American on a daily basis.

The Commission can forestall these adverse results only by requiring MCI to divest UUNet prior to the consummation of the merger.

Just as the case for requiring MCI to divest some of its Internet backbone assets is clear, so is the case for requiring it to divest UUNet rather than the Sprint Internet backbone. In 1998 the Commission faced a nearly identical situation with the proposed merger of MCI and WorldCom. To ensure that the Internet backbone market remained competitive, the Commission approved the merger only on the condition that MCI divest its iMCI Internet business. The European Commission, with the active support and endorsement of the Department of Justice, previously had reached the same conclusion. Unfortunately, MCI never complied with its commitment to fully divest the iMCI business, which has resulted in a spate of litigation, arbitrations, and regulatory proceedings between MCI and C&W. As we describe with supporting affidavits below, MCI transferred to C&W an entity that could not function as a strong, stand-alone Internet backbone provider at the time of divestiture, and which was a far weaker competitor in this critical market segment that the iMCI business previously had been. Although C&W has undertaken significant remedial efforts and committed substantial resources to establish its Internet business as a strong competitor in the market, many of these actions would never have had to be taken if MCI had fulfilled the commitments it made to the EC, DOJ, the Commission and C&W.

The key factor that enabled MCI to weaken the divested entity as an independent Internet backbone competitor was the tight integration between the iMCI business and MCI's other telecommunications and non-Internet businesses. The iMCI business shared resources with MCI at nearly all levels, and the divestiture could not succeed in retaining iMCI's market strength without extensive ongoing support from and interaction with MCI. Because MCI planned to compete with the divested entity through UUNet after the merger, it had no incentive to make the divestiture work, and in fact its incentives were to sabotage the divested entity to entrench UUNet's market position. The lesson to be learned from the iMCI debacle is that the forced divestiture of an integrated Internet backbone business by a parent company which will compete aggressively with the divested entity inevitably results in a weakened competitor and reduced competition in the market.

In the instant merger, Sprint's Internet backbone business is relatively fully integrated with its long distance business, thereby presenting the Commission with virtually the same situation as the iMCI divestiture. By contrast, MCI's Internet backbone business, UUNet, is not integrated with MCI to nearly the same extent, and it can be spun off as a strong competitor at the time of divestiture with only modest Commission oversight and enforcement. Therefore, the public interest requires that the Commission condition its approval of the merger upon the divestiture of UUNet, not Sprint's Internet backbone assets.

II. The Internet Backbone In The United States

The Internet operates through globally interconnected packet-switched networks, which are comprised primarily of routers and high-speed transmission facilities.[6] The glue that holds the Internet together is the interconnection arrangements among Internet backbone providers, and between those providers and ISPs. Those arrangements ensure that every Internet user is able to communicate with every other Internet user through its chosen ISP.

Prior to the MCI / WorldCom merger, there were four primary Internet backbone providers: UUNet, Sprint, ANS, and MCI. WorldCom subsequently acquired control of UUNet and ANS backbones, and C&W acquired the iMCI Internet business.[7] Today, the majority of the traffic on the Internet is carried over a handful of backbone networks, namely MCI/UUNet, Sprint, GTE, AT&T and C&W.[8] Internet backbone providers exchange traffic at either public or private Network Access Points or private points of interconnection.

In 1995-1996, the largest Internet backbone providers began to establish so-called "peering" arrangements with each other. Peering is a contractual arrangement whereby two entities agree to exchange and terminate each other's Internet traffic without imposing charges or requiring net settlement payments from each other. Peering arrangements remain in place today

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6 *See MCI WorldCom Merger Order at* para. 143 n.383 (stating that "[r]outers are switching devices that direct packet traffic by examining the address contained in each packet and forwarding it according to directions stored in routing tables."). ISPs provide access for customers to the Internet and the World Wide Web. Harry Newton, Newton's Telecom Dictionary 434 (13th ed. 1999).

7 *See* Pearce Affidavit at 22.

8 *See The Future Of The Internet*, Datamonitor, 37 (1999); Pearce Affidavit at 14.

among the largest Internet backbone providers, and they are a principal factor in keeping ISP rates to subscribers as low as they are today. In addition, Internet backbone providers enter into so-called "transit" relationships with smaller backbone providers or ISPs whereby the former receives fees from the latter for transporting and terminating Internet traffic. Transit arrangements are prevalent when there is a significant imbalance in the traffic flows between entities to warrant the payment of compensation. Although UUNet today is close to occupying a dominant position in the Internet backbone market, C&W believes that market forces have strongly influenced which relationships are governed by peering arrangements and which are governed by transit arrangements.

Today, one carrier enjoys a commanding position in the Internet backbone market. By revenue, MCI has a market share of 37%, which is more than double the 15% market share of its nearest competitor, GTE. Given Sprint's current 8% market share, this merger would result in one entity controlling at least 45% of the total Internet backbone market.[9]

MCI's significant market position assists it in obtaining wholesale revenues in excess of its relative position in the backbone market. Specifically, MCI has parlayed its 37% backbone market share (measured by revenues) into 56.7% of the wholesale services market.[10] Sprint is also able to leverage its backbone position with 11.2% of the wholesale services market by revenue.[11] As a result, the Combined Carrier would control nearly 70% of the Internet wholesale service market and be able to further leverage its market dominance.[12]

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9 *See* Pearce Affidavit at 11-15.

10 Pearce Affidavit at 11.

11 *Id.*

12 Pearce Affidavit at 12.

Other indicators confirm the Combined Carrier's dominance. MCI is the number one provider of Internet services to business customers, serving more than 70,000 nationwide.[13] MCI has invested aggressively in building out its Internet infrastructure, resulting in a ten-fold expansion of bandwidth in a single year.[14] At least in part due to that investment, MCI's fourth quarter profit realization nearly tripled, with Internet revenues rising 15% to $8.8 billion.[15] By virtually any measure, MCI has a commanding position in the Internet backbone market and the addition of Sprint's internet backbone will entrench its dominance of this market sector.

III. The Concentration In Internet Backbone That The Sprint / MCI Merger Contemplates Will Be Harmful To The Public

For the industries that support and utilize the Internet, the stakes raised in this proceeding could not be higher. Founded on the premise of an open architecture and ready accessibility, the Internet has grown from less than 5 million online users in 1992 to 27 million users in 1996 to more than 80 million users today.[16] The key to the continued growth and widespread availability of the Internet at affordable prices is a competitive backbone market.

It is appropriate for the Commission to address the issue of excessive concentration in the Internet backbone market. The Commission has decades of experience regulating dominant carriers in various telecommunications markets, and it knows first-hand the problems of preserving and promoting competitive entry in the face of an entrenched carrier with enormous size and market share advantages. As a result, the Commission is uniquely qualified to

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13 *See* Pearce Affidavit at 12-13; *AOL Canada Inc., Bell Nexxia and UUNet Canada Join Forces to more Than Triple the Size of AOL Canada's Access Network* (Nov. 30, 1999).

14 Pearce Affidavit at 15-16.

15 *MCI WorldCom's Q4 Profit Surge*, Yahoo News (Feb. 10, 2000).

16 *Kennard Sees Telecom Act's 4th Anniversary as Start of Internet Age*, Internet Regulation Alert (Feb. 11, 2000).

understand the danger that the proposed merger presents to the Internet and U.S. consumers, and to impose the conditions necessary to ensure a broadly competitive Internet backbone market. In this Section, C&W demonstrates that approving the merger without conditions would create a single dominant Internet backbone carrier and that such an entity would reduce competition and harm consumers.

A. The Internet Backbone Is A Separate Market

In his March 13, 1998 Affidavit, which was filed in the MCI / WorldCom merger proceedings, Dr. Robert G. Harris concluded that the Internet backbone market is a separate product market because "there do not appear to be good demand substitutes for ISPs and other backbone service providers to obtain national Internet access (*i.e.*, to end users or content served by a different ISP) if a hypothetical backbone service monopolist were to raise its connection price above competitive levels."[17] In the *MCI WorldCom Merger Order*, the Commission agreed with Dr. Harris' analysis.[18] Rejecting the argument that transmission facilities are fungible between Internet services and other circuit- and packet-switched services, the Commission agreed that Internet backbone service is a distinct market of nationwide scope.[19]

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17 GTE March 13, 1998 Comments, CC Docket 97-211, attaching *Internet Affidavit of Robert G. Harris* at 7.

18 *See MCI WorldCom Merger Order* at para. 148.

19 *Id. See also* Letter from Michael B. Fingerhut, General Attorney, Sprint, to Magalie Roman Salas, Secretary, FCC, Attach. Charles River Assocs. Inc. Report at 9 (filed June 1, 1998) ("Sprint Charles River Study") (finding that "[b]ecause there are no close substitutes for the access services provided by core Internet backbone providers, the provisions of core internet backbone services is a relevant antitrust market and the output of non-core backbone providers and other ISPs should not be counted in computing market shares.").

Nothing has changed since the MCI / WorldCom merger to alter the Commission's earlier conclusion.[20] In the attached affidavit, Dr. Pearce confirms that the Internet backbone is a separate product market. As Dr. Pearce explains, "[e]xperts agree that Internet backbone service represents a product market because there are no acceptable demand substitutes for ISPs and other backbone service providers to obtain national Internet access if a hypothetical backbone monopolist were to raise its connection price above competitive levels."[21] As Dr. Pearce further notes, "[t]his market is distinguishable from the position of secondary peering ISPs (who peer with some though not all of the top-level ISPs, and also rely on transit agreements), and 'resellers' (who rely entirely on transit agreements with top-level ISPs)."[22] In sum, the Commission should find that Internet backbone service "constitutes a separate relevant product market"[23] and examine this merger in light of the consequences it will have on that market.

B. HHI and Other Indicators Show Undue Concentration

By revenue, MCI is by far the dominant Internet backbone provider, with two-and-one-half times the market share of its closest rival, GTE-BBN.[24] Recent estimates show that UUNet, by itself, dominates the market for top-level Internet backbone providers, carrying an estimated

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20 Pearce Affidavit at 1-2.

21 Pearce Affidavit at 5.

22 Pearce Affidavit at 1, 10.

23 *MCI WorldCom Merger Order*, at para. 148 (citing GTE Mar. 13 Comments, Harris Internet Aff. at 7; AFLO-CIO Jan. 5 Comments at 3; CUIISP Mar. 20 Reply Comments at 2, CWA Jan. 5 Comments at 5-7; CWA Jan. 26 Reply Comments at 4; CWA Mar. 20 Reply Comments at 18-20; GTE Mar. 13 Comments at 66-68; GTE June 11 Comments at 10-11; ICP Jan. 5 Comments at 10; Simply internet Jan. 5 petition at 6; Sprint Mar. 13 Comments at 7-9; Sprint Charles River Study at 7-9).

24 GTE and Bell Atlantic have recently proposed a divestiture of GTE Internetworking to address Section 271 problems with their merger. *GTE Corp., Transferor, and Bell Atlantic Corp., Transferee For Consent to Transfer of Control*, CC Docket No. 98-184, Supplemental Filing of Bell Atlantic and GTE (Jan. 27, 2000.

50 percent of Web traffic, even before combining with Sprint.[25] Similarly, International Data Corporation noted that MCI has "clear predominance" in the Internet business and wholesale markets.[26] Given Sprint's previous statements opposing the MCI / WorldCom merger because it would consolidate over 54 percent of all non-backbone ISPs onto a single network,[27] even Sprint has to concede that the merger would result in a dangerous level of backbone concentration.

Combining the MCI and Sprint Internet businesses would significantly enhance UUNet's already nearly dominant position in the Internet backbone market. As the Yankee Group observed in October 1999, "a combined MCI-Sprint would represent between 60% and 70% of the Internet backbone market." The Yankee Group further observed that the combined entity would own and operate six of the eight largest traffic exchange points on the public Internet and "create an unhealthy balance of power" in the Internet backbone market.[28] International Data Corp.'s 1999 analysis of ISP Wholesale Services Revenues and Shares shows that MCI with a 56.7 percent share and Sprint with an 11.2 percent share, representing a combined share of 67.9 percent.[29]

The Commission's analysis of mergers properly includes consideration of the merger's competitive impact by assessing both the current market concentration and the likely increase in

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25 Carleen Hawn, *Swimming with Sharks*, Forbes (Jan. 10, 2000); Alan Cane, *Companies & Finance: The Americas*, Financial Times at 33 (Nov. 9, 1999).

26 1998 ISP Market Review and Forecast 1998-2003 at 2, 17.

27 Sprint FCC Comments at 10 (Mar. 13, 1998) (citing survey data compiled by *Boardwatch*).

28 *See MCI WorldCom and Sprint Merger: Telecom Fusion: The World is Getting Smaller*, Yankee Group at 11 (Oct. 15, 1999).

29 *See* Internet Service Provider Market Review and Forecast, 1998-2003, International Data Corp. (ww.idc.com) at 22, 30 and Table 15 Internet Service Provider Wholesale Services Revenues and Share, 1999; *see also* Pearce Affidavit at 12.

market concentration resulting from the merger, as measured by the Herfindahl-Hirschman Index ("HHI").[30] As the 1992 Horizontal Merger Guidelines indicate, and as applied by the Commission, the HHI analysis provides guidance regarding the potential anti-competitive effects of a merger. Although the Commission has correctly rejected rigid adherence to HHI analysis,[31] such analysis nevertheless remains a potent indicator of the anti-competitive effects of a merger within a market.

The pre-merger HHI for the Internet backbone market is 1,774, and the post-merger HHI is nearly 500 points higher at 2,266.[32] Under the 1992 Horizontal Merger Guidelines, such an increase in the HHI indicates that the proposed merger presumptively creates or facilitates the exercise of market power.[33] Without overstating the significance of the HHI calculations, these data can and should play an important role in the Commission's review of this proposed merger.

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30 *See 1992 Horizontal Merger Guidelines*, 57 Fed. Reg. at 41,558, Sec. 1.51 (a)-(c). Under the 1992 Horizontal Merger Guidelines, if the post-merger HHI is below 1000, the market is considered unconcentrated and the merger requires no further analysis; if the post-merger HHI is between 1000 and 1800, the market is considered moderately concentrated and an increase in HHI of more than 100 signals potential significant competitive concerns; and if the post-merger HHI is above 1800, the market is considered highly concentrated and an increase in HHI of more than 50 signals potential significant competitive concerns. The Commission has used HHI analysis in numerous contexts as an initial means of measuring the significance of changes in market concentration. *See, e.g., Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Third Annual Report, 12 FCC Rcd 4358, 4419-20, paras. 120-21 (1997); Amendment of Parts 20 & 24 of the Commission's Rules -- Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap, 11 FCC Rcd 7824, 7869-73, 7899-904 (1996). The HHI has also been used by antitrust courts as a basic tool and has been called "a standard measure of market concentration." *Western Resources, Inc. v. Surface Trans. Board*, 109 F.3d 782, 785 (D.C. Cir. 1997); *FTC v. University Health, Inc.*, 938 F.2d 1206, 1211-12 (finding the HHI "the most prominent method of measuring market concentration.").

31 *MCI WorldCom Merger Order* at para. 37.

32 *See* Pearce Affidavit at 16-18.

33 *Id.*

particularly since they confirm the dangers highlighted by other indicia of market concentration and power.

It is unlikely that new or potential entrants will be able to gain any significant market share to blunt the anti-competitive impact of the merger of MCI and Sprint. The combination of MCI's already commanding market position with the nature of the Internet backbone architecture and technology prevent potential competitors from diminishing the harmful effects of the Combined Carrier without an effective divestiture. For an Internet backbone provider, market position is determined by two key elements -- customers and access to content (*i.e.*, web pages). Merely building a high-capacity fiber optic transmission network does not guarantee an entity that it will have a significant position in the Internet backbone market, or that it will even succeed in sustaining entry into the market. For purposes of establishing market position, a backbone network is only as good as the access it provides to the maximum number of customers and websites.

Because the Combined Carrier would be so dominant in the Internet backbone arena, every Internet backbone carrier would require interconnection to the Combined Carrier's backbone to reach the customers and websites desired by end-users. In effect, the Combined Carrier would be able to operate as the gatekeeper to the Internet, thereby allowing it to dictate every aspect of the transport and provision of Internet services.[34]

Without access to content except through the Combined Carrier, the ability of a both existing backbone providers and new backbone entrants to attract customers is greatly

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[34] In connection with the MCI WorldCom merger, Sprint accurately pointed out that a new backbone entrant must attract a "sufficient number of unique internet addresses to be able to bargain effectively with incumbent core backbone providers for settlement-free interconnection." Sprint criticized the MCI WorldCom merger because it would significantly increase the number of users that a new entrant must attract before it qualifies for peering. *See* Sprint Charles River Study at 22.

diminished. Specifically, if an ISP were choosing an Internet backbone carrier, the Combined Carrier has a significant built-in competitive advantage because of the direct access it affords to the most customers and content. By contrast, a new entrant could not survive unless it interconnected with the Combined Carrier, which would add a layer of costs and complexity not faced by the Combined Carrier. Particularly if the Combined Carrier integrates vertically into the ISP market, the obstacles facing a new backbone entrant attempting to sign up a critical mass of customers would be significant.[35] In that situation, only significant, intrusive and persistent Government intervention would prevent Internet competitors and customers from becoming the indentured servants of the Combined Carrier.

C. The Internet Backbone Market Is Susceptible To Tipping

The Internet backbone market is susceptible of being tipped into a monopoly and, once that occurs, it will be difficult if not impossible to restore competitive conditions. A market is susceptible to tipping where increased concentration makes it substantially more difficult for potential competitors to supply services at competitive prices.[36] Tipping is unlikely to occur only where new entrants can still achieve the necessary economies of scale necessary to compete with incumbent operators.[37] Here, the principal value of an Internet backbone network is the access it offers to customers and content. No competitor can match the customer and website access offered by MCI over its backbone network, and the merger with Sprint will further

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35 In addition, the scarcity and method of Internet addressing poses an entry barrier for Internet backbone providers. If an ISP wishes to change its Internet backbone provider, then it must obtain new addresses from its new backbone provider. It must then take the time and expense to renumber its entire network and its customers' network as well. *See generally MCI WorldCom Merger Order* at para. 149-50 n.396.

36 William J. Kolasky, *Network Effects: A Contrarian View*, 7 Geo. Mason L. Rev. 577 (Spring 1999).

37 *Id.*

insulate MCI from the competitive discipline of new entry. Based on Metcalfe's law, which posits that the value of a network is its customer base squared,[38] the adverse impact of this merger on backbone competition will be far greater than the incremental market share that MCI will gain. Thus, the market is likely to "tip" due to this merger because smaller carriers will not be able to achieve the economies of scale necessary to compete against MCI as a new entrant.[39]

D. The Merger Will Have A Devastating Anti-Competitive Impact

1. The Internet Backbone Marketplace

The ascent of a dominant Internet backbone carrier will have a cascading effect throughout the Internet marketplace, ultimately resulting in less competition and higher prices for consumers. Although UUNet is by far the largest backbone carrier and already is close to achieving dominant carrier status, C&W believes that market forces still play a formative role in this industry segment. However, that role will end abruptly if the Commission permits MCI and Sprint to create a backbone carrier more than double the size of its next largest competitor.

Initially, current peering and transit relationships will be in serious jeopardy due to the enormous disparity in market share and size between the Combined Carrier and other backbone providers. That disparity will be compounded by the fact that the Combined Carrier will have established access to America Online and EarthLink, the two largest ISPs.[40] While no

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[38] Newton's Telecom Dictionary at 517 (15th Ed. 1999); *see also* Pearce Affidavit at 24.

[39] *See* Joel Klein and Pretta Bausal, *International Antitrust Enforcement in the Computer Industry*, 41 Vill. L. Rev. 173 (1996).

[40] MCI WorldCom is AOL's primary backbone carrier, through various wholesale agreements. Commenting on the Time Warner / AOL merger, MCI WorldCom's Ebbers explained that "we are confident that our revenue stream will increase and not decrease" as a result of the merger. MCI WorldCom Vice Chairman John Sigmore told analysts that he expects the MCI WorldCom's relationship with AOL "will expand and not contract." *Data, Internet Drive 211% Income for MCI WorldCom*, Communications Daily (Feb. 11, 2000). Sprint owns 28 percent of EarthLink Networks; the new EarthLink Board of Directors will include representatives from Sprint. Frances Katz,

competitor would be able to compete without access to the Combined Carrier's customers and websites, the Combined Carrier would not be similarly dependent upon any other backbone provider. As a result, the Combined Carrier would have the market power and the economic incentive to maximize profits by eliminating peering arrangements. Similarly, the Combined Carrier could be expected to increase the rates paid by carriers who interconnect with MCI today on a transit basis. Those rates would reflect the Combined Carrier's new-found market power, not the workings of a competitive marketplace.[41] Other carriers and ISPs would have no feasible alternative but to accept the transit rates imposed by MCI because they could not hope to survive without access to MCI's customer base and websites.[42]

The key to a competitive Internet backbone market is making sure that all providers, including the largest carriers, require access to each others' networks in order to survive in the marketplace. This marketplace setting encourages the largest carriers to enter into peering arrangements with each other and to establish market-based transit arrangements with smaller carriers and ISPs. However, the dynamics of the Internet backbone market change radically once the largest carrier becomes so dominant as to conclude that it can survive at little or no competitive cost even were it not connected with all other networks. At that point, the largest backbone carrier is able to impose its will on the other providers and dictate where, how and at what cost interconnection will occur. Its profit-maximizing behavior changes from entering into low-cost peering and transit arrangements (which benefit consumers through low ISP rates) to

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MindSpring Merger with EarthLink Wins, The Atlanta Journal and Constitution, 1E (Feb. 5, 2000); *EarthLink, MindSpring Merge, Forming No. 2 ISP*, Yahoo News (Feb. 4, 2000); Pearce Affidavit at 21.

41 Pearce Affidavit at 30-32.

42 Pearce Affidavit at 26-28; Sprint Charles River Study at 20-21 (the Combined Carrier "may be able to provide low-quality interconnection to, or refuse to interconnect with, new entrants, in order to impose significant charges for interconnection.").

eliminating peering arrangements and charging above-market transit rates for all interconnection (which harm consumers through high ISP rates). If the Commission permits MCI and Sprint to combine their Internet backbone networks, the Combined Carrier would become a carrier whose profit-maximizing behavior would be anathema to the competitive operations of the backbone market.

In the event the Combined Carrier sought to wield market power by imposing high transit rates on all interconnecting carriers and ISPs, existing backbone providers then would have a strong incentive to consolidate their networks, traffic, customers and websites in order to reduce their unit costs and minimize the damage inflicted by the dominant carrier's transit rates. Similarly, new entry would be deterred if not precluded altogether. Once a market has tipped into monopoly, new entry is discouraged because the cost of competing with the dominant carrier is so high while the likelihood of establishing a profitable market presence is so low.[43] UUNet's John Sidgmore recognized this phenomenon when he stated that "having a big network is a huge barrier to entry for competitors."[44]

Similarly, the Combined Carrier would have both the incentive and ability to engage in discriminatory interconnection practices in order to prevent competitors from challenging its market dominance. In particular, the Combined Carrier could discipline its competitors without ever being forced to cut off interconnection. For example, it could refuse to expand interconnection trunks in response to growing congestion, or to establish new points of interconnection in response to changing traffic configurations. As Sprint explained in

43 "Potential entrants will face higher entry barriers after the merger because they will have to enter at a larger scale." Sprint Charles River Study at 21.

44 Rajiv Chandrasekaran, *Making UUNet Into a Very Big Deal; With His Agreement With CompuServe and AOL, CEO John Sidgmore Takes It To Another Level*, Wash. Post, 12 (Sept. 29, 1997).

WorldCom's last merger review, "a larger core backbone operator has an incentive to threaten, at least implicitly, to degrade the quality of interconnection to, or to disconnect entirely from, its rivals in order to gain a competitive advantage."[45] Through these types of strategic actions, the Combined Carrier could effectively keep Internet backbone competition on a leash without losing any of its market dominance.

2. ISPs and ASPs

The increased Internet backbone concentration caused by this merger will have an adverse impact on every Internet-related marketplace, not just the backbone market. For ISPs and ASPs, the likely elimination of peering arrangements and the increase in transit rates will have a significant adverse impact on their long-haul costs. As with backbone providers, this new environment will deter new entities from entering the ISP market, while encouraging existing ISPs to consolidate in an effort to minimize costs and maximize interconnection quality. Growth in the ISP market will be reversed, and the fast pace of technological and service innovation will be slowed.

Further, because the Internet business of Sprint and MCI operate vertically-integrated ISPs of their own, the Combined Carrier could seek to dominate the ISP market by discriminating against other ISPs. The dominant position held by the Combined Carrier in the backbone market also provides it the ability to dominate the ISP marketplace. Thus, if approved,

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45 The Charles River study submitted on behalf of Sprint in 1998 correctly noted "that the ability of any backbone provider to resist a threat to have the quality of its interconnection degraded is increased the greater is the share of the market held by that provider . . . this is because a provider with a larger market share has less to lose from quality degradation or disconnection than one with a small share." Sprint Charles River Study at 15; *see also* Internet Affidavit of Robert Harris on behalf of GTE, CC Docket No. 97-211 (Mar. 13, 1998).

the merger could deliver not one, but two Internet markets (backbone and ISP/ASPs) to the Combined Carrier on a silver platter.

3. Advanced Services Market

In numerous recent decisions, the FCC has recognized Congress' desire to develop the advanced services marketplace to the benefit of all Americans as quickly as possible.[46] In recent months, the industry has seen the emergence of xDSL services, which promise to offer affordable, broadband access to the Internet to a wide array of business and residential users. The Commission has sought to implement Congress' objectives by ensuring a regulatory environment that is conducive to the development and roll-out of these services by new entrants into the market.[47] Contrary to Congress' wishes and the Commission's clear policy goals, the combination of MCI's and Sprint's Internet backbone networks would stunt the growth of emerging advanced services such as xDSL. Due to the increase in ISP rates in response to the cost increases caused by the Combined Carrier, fewer consumers would be able to afford broadband access through xDSL technologies. With fewer consumers able to afford these services, the ability of multiple carriers to achieve the economies of scale necessary to enter the market efficiently would be undermined. The result would be fewer xDSL entrants, geographically limited service offerings, and much higher rates.

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46 *See* 47 U.S.C. § 157; *see generally Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket 98-146, Report, 13 FCC Rcd 15280 (1999).

47 *See, e.g., Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 17 CR 3020 (Nov. 5, 1999).

Similarly, the emerging market for premium Internet services such as IP telephony, real-time video conferencing, and mission-critical business applications would be undermined.[48] The dominant market share of the Combined Carrier would make it the only carrier able to guarantee the high quality of backbone transmission necessary to support advanced-service applications thus denying all competition in these crucial application markets. These services are particularly vulnerable to degradation through congestion and traffic flow delays. Only the Combined Carrier would be able to guarantee the high quality of backbone transmission necessary to support these services, and it could ensure that no other backbone carrier would be able to offer competing guarantees. In very real terms, the development and growth of new Internet-based services would be in the hands of the Combined Carrier as the dominant provider of Internet backbone services.

4. Consumers

The Combined Carrier would severely harm U.S. consumers. The combination of increasing interconnection costs and accelerated consolidation in the backbone and ISP/ASP markets would result in substantial increases in the rates paid by American consumers for Internet services. Some consumers who now can afford such services will be driven from the Internet by the rate hikes, while other consumers who might have gained access to the Internet for the first time will be deterred by the high costs. The increase in ISP rates will exacerbate the large and growing Digital Divide between Americans who have access to the Internet and those who cannot afford it.[49]

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48 *See* Pearce Affidavit at 32; Harris Affidavit at 4-5.

49 *See generally Falling Through the Net: Defining the Digital Divide*, Department of Commerce, National Telecommunications and Information Administration, at 43 (rel. July 1999) ("Digital Divide"); *E-Rate: A Success Story*, Address by Chairman William E.

Further, consumers would be harmed by the adverse impact of the Combined Carrier upon technological and service innovation. Simply put, consumers will have fewer choices among fewer services than would be the case with a competitive backbone market. In addition, the current emergence of advanced services, such as xDSL services, would be slowed considerably. Many consumers who today could afford to purchase such services will be prevented from doing so post-merger by the higher prices they will have to pay for Internet services and broadband access services, such as xDSL. Similarly, the introduction of premium Internet services will be limited to those business and other customers who are able to pay the above-market rates that the Combined Carrier would have the ability and incentive to charge for these new services.

5. The Public Interest

The Commission must consider now the regulatory consequences of permitting MCI and Sprint to seize a dominant position in the Internet backbone market through the proposed merger. The backbone market today is a competitive market. This competition ensures that consumers face lower prices, additional services, and increased innovation. In many ways, today's competitive backbone market is a model for the type of competition that the Commission is trying to encourage in the traditional telecommunications marketplace. This merger presents the Commission with two stark choices. Either it can preserve the competitive environment in the Internet backbone market and continue to ensure maximum consumer welfare through robust competition or it can idly stand by and unnecessarily face the prospect of regulating the Internet.

Kennard, FCC, to the Educational Technology Leadership Conference – 2000, Council of Chief State School Officers (Jan. 14, 2000) (as prepared for delivery).

For the first time, the Commission would be forced to regulate relationships and behavior that today are governed primarily by the marketplace. In particular, the Commission would have to develop an extensive and intrusive regime to regulate the interconnection rates and practices of the Combined Carrier. This regime would bear more than passing similarity to the market-opening obligations imposed by Congress on incumbent local exchange carriers in Section 251(c)(3) of the Communications Act.[50] Interconnection agreements with the Combined Carrier would come to resemble those negotiated and arbitrated under Sections 251-252 of the Communications Act, and the Commission would be called upon to resolve disputes including, among other things, cost-based interconnection rates, impaired or delayed collocation at MCI's facilities, and the timely availability of adequate trunking capacity for interconnecting carriers.

On the other hand, approving the merger on the condition of the divestiture of UUNet will leave the marketplace to effectively self regulate the terms and conditions of service. Market forces will generally determine fair pricing and acceptable service levels. By avoiding the need to regulate a dominant provider, the Commission will protect a competitive market and remain consistent with its tradition of encouraging open and unregulated growth of the Internet.

IV. The Commission Should Require MCI To Divest UUNet As A Condition Of Approving The Merger With Sprint

A. Overview

As C&W demonstrated in the previous sections, the merger of MCI and Sprint would entrench MCI as the dominant Internet backbone service provider. The combined entity would have severe negative effects on competition, customers and technology. As a result, the Commission must condition its approval as necessary to ensure that the merger promotes the

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[50] 47 U.S.C. 251(c)(3) (unbundled access requirements).